

PERFECT COMPETITION

- The characteristics of an industry in a perfect market are:
- There are a large number of firms
- Each firm is small and cannot effect the industry as a whole
- All firms produce “homogeneous” products
- There are no barriers to entry to, or exit from the industry
- All producers and consumers have ‘perfect knowledge’.

In a perfect market firms cannot affect the industry as a whole. They are ‘**price-takers**’.

Normal demand and supply curves exist. Consumers and producers will come together in the market and the forces of demand and supply will determine the equilibrium price and quantity. This price is set by the industry and this will form a perfectly elastic demand curve ($P = D = AR = MR$) for each firm.

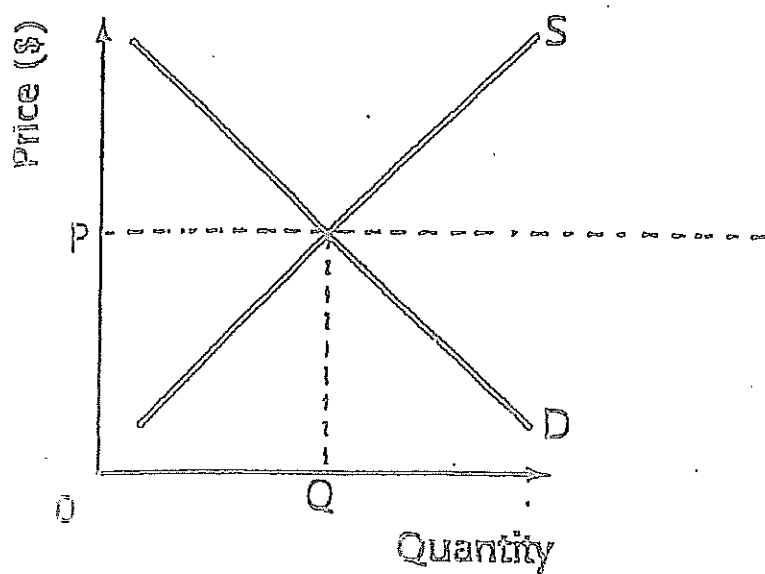
(INSERT GRAPH/S)

Profit maximisation occurs when a firm produces at the level of output where $MC=MR$.

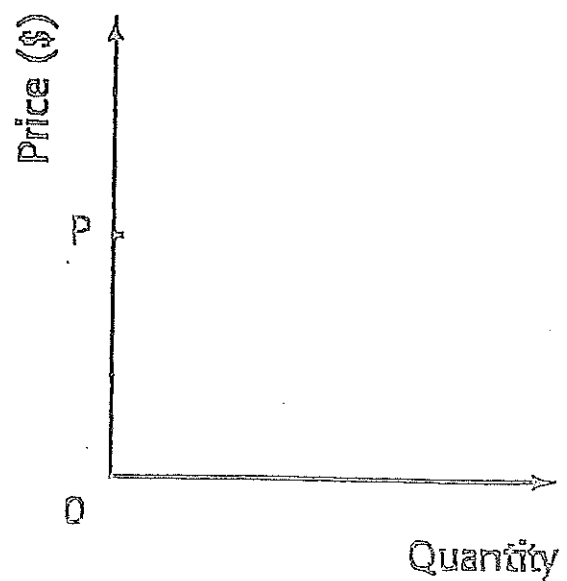
(insert graph/s)

The aggregate production for all firms will be the market equilibrium quantity.

The industry



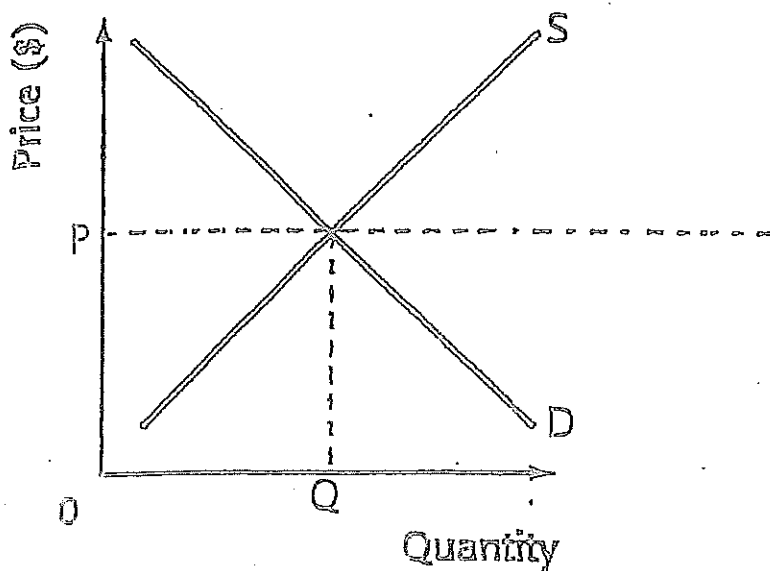
The firm



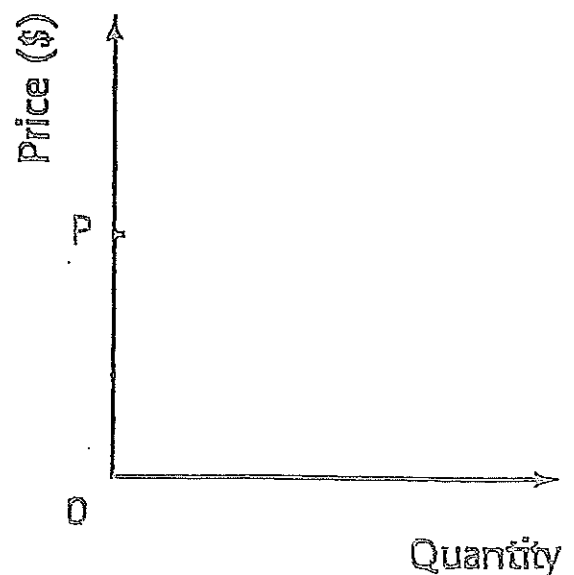
Short-run abnormal profits occur when a firm is able to sell at the market prices when its average cost per unit is lower than that price. This can only occur in the short-run. (insert graph)

Other firms will be attracted by the abnormal profits available and, as more firms enter the industry, the Supply curve will shift to the right. The market price will be forced lower until all firms are taking 'normal profits' with the price per unit (AR) equal to the cost per unit (AC). The market finds its long-run equilibrium point. (insert graph)

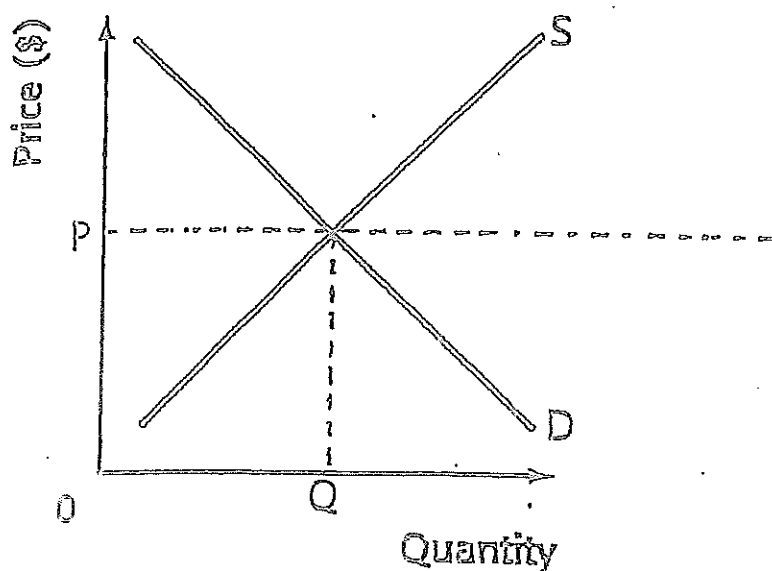
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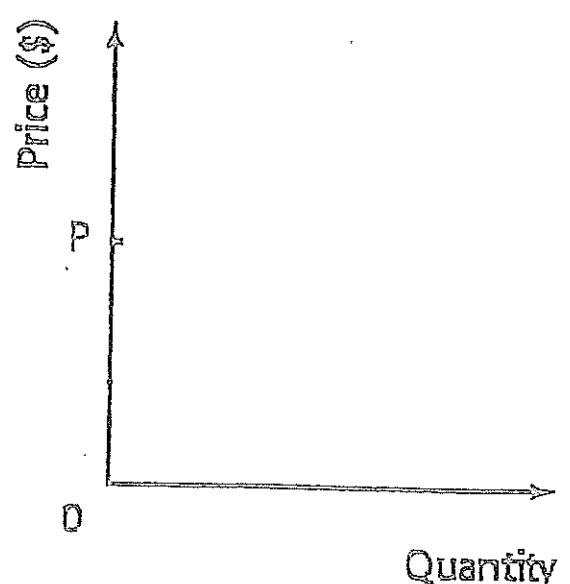
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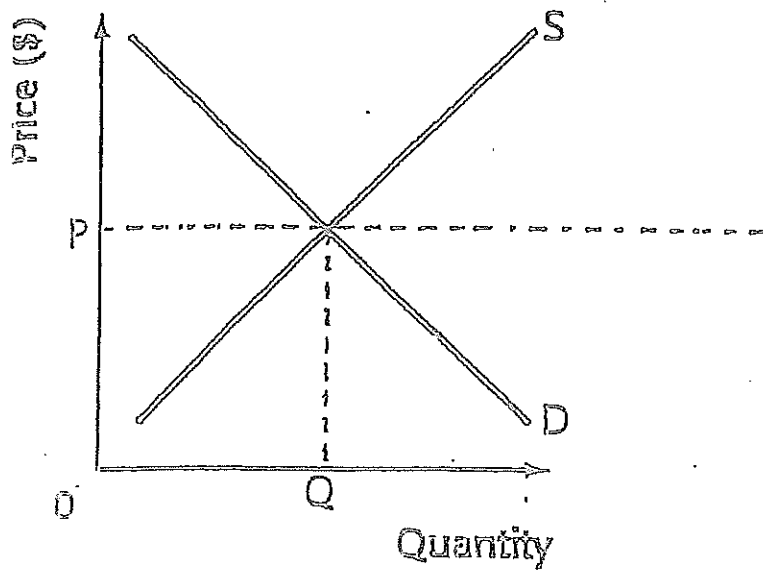
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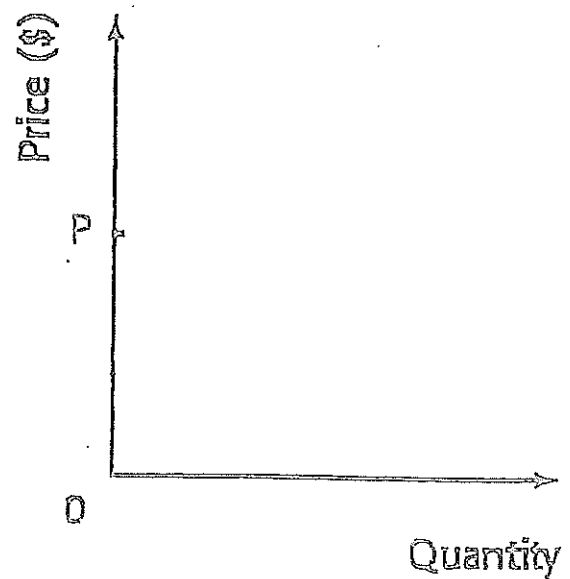
Short-run (abnormal) losses occur when a firm sells at a price where the cost of each additional unit (MC) is equal to the revenue from each additional unit (MR) but that price does not cover its costs per unit. This will only occur in the short-run. (insert graph)

Firms will leave the industry and the Supply curve will shift to the left. The market price will be forced higher until all firms are taking 'normal profits' with the price per unit (AR) equal to the cost per unit (AC). The market finds its long-run equilibrium point. (insert graph)

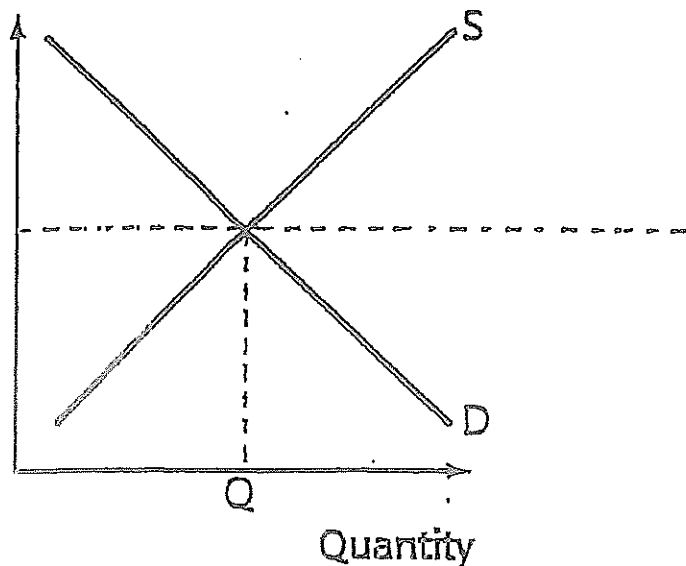
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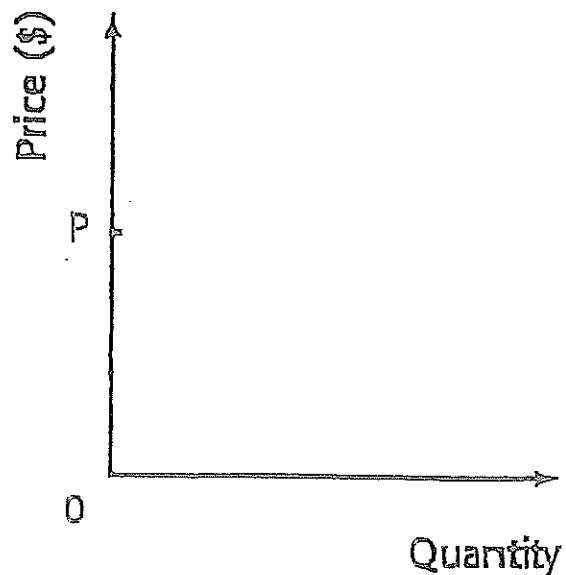
The firm



The industry



The firm



Long run equilibrium is found as firms enter an industry offering short-run abnormal profits or leave an industry that provides short-run losses.

Firms will make normal profits in the long-run.

This equilibrium will persist until the conditions of the market (ie factors determining demand or factors determining supply) change.

(insert graph)

